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Comments:

I am a financial planner with an unusual twist – I am a licensed mortgage loan originator operating as an employee of a local mortgage broker for the purpose of mortgage loan origination. I have been in the mortgage business for 13 years. At this point in my career I originate just a few loans each year, primarily as a service to existing financial planning clients but occasionally from call-in mortgage shoppers. As I adopted a fiduciary standard for my practice several years ago, I examined every aspect of the services I provided. At that time I had finally, but not easily, come to understand what Yield Spread Premium really is. After a few years of research and study, I have concluded that, in the brokered transaction, YSP can only be considered to be money that belongs to the borrower. YSP is simply the premium component of the price that the lender pays for the borrower's note. In the brokered transaction the lender is purchasing that note directly from the borrower with the broker providing origination services, i.e., services needed to create a marketable note. So, in keeping with my transition to practice as a fiduciary, I began crediting YSP to my mortgage customers in the 200 section of the HUD-1. I show that credit on the Good Faith Estimate as well. I began doing this in about 1999. I find that I have to closely monitor the preparation of the HUD-1 by the settlement agent because I know that, in spite of the direction given, they are likely not to show the YSP as a credit to the borrower – this is simply a practice that is almost unheard of. Another important aspect of my practice is that I quote my origination fee as a single dollar amount, up front, before the engagement is agreed to. For my fee, I selected an amount that is reflective of my time and effort. As a financial planner I bill at $150/hour for planning services. I have several years of study and experience under my belt that I feel justifies that rate. I cannot rationally justify charging a rate in excess of that for mortgage origination services. After all, at the time I began doing this, a loan originator required no formal training or licensing. Today, in my state, loan originators (LO's) are at least required to be licensed. My fee does not vary with interest rate, it does not vary with loan amount. I might change it for a case that clearly would demand more work than a typical mortgage. But the process is pretty much a constant across a wide variety of case descriptions. As you might guess, this pricing and YSP crediting formula is unusual. One of the interesting consequences of this practice is that I routinely produce (using a simple MS Excel program I created) a spreadsheet for prospective mortgage clients – at the time of the first meeting – that shows a summary of 6 GFE's, one at each of six interest rates ranging from 3/8% below the par rate to 3/8% above the par rate. In each interest rate scenario, the constants are my origination fees and estimated third party fees. The variables are the discount points or YSP that either add to or subtract from the closing cost. This gives the prospective borrower a clear sense of how his payment and closing costs will vary over a range of interest rates. The most common question a prospective borrower asks when shopping for a mortgage is, "what is your interest rate?" My process changes this question to, "what interest rate works best for me?" This is, I believe, as it should be. The customer should know what the consequence is to him in terms of loan payment and cash needed to close as he selects an interest rate. Oh, I also emphasize that the while my origination fee is fully disclosed up front and will not change, the discount points or YSP are a function of the market and will change at least daily until the loan is locked. I believe that, given the complexity of the loan fee and price structure, the practice of crediting YSP to the borrower is not only the simplest solution but it is the only solution given the true nature of YSP. Comments: Regarding your definition of Yield Spread Premium: The definition of Yield Spread Premium contained in the proposed change is wrong – dead wrong. First, there is no present dollar value of an "interest rate". One can compute a present dollar value of an interest payment – is that what you meant to say? One might presume that you meant to say: "YSP is the difference between the present dollar value of the interest payments for a loan at the lowest interest rate the wholesale lender would have accepted on a particular transaction and the interest payments on a loan at the interest rate the broker actually obtained for the lender." Seems like a minor correction, but we don't want the Board of Governors of the Federal Reserve System to appear financially illiterate. Assuming that this is what was meant, your definition is fundamentally wrong. By such a definition, every loan originated at a rate greater than the "lowest rate the wholesale lender would have accepted" would have YSP associated with it. This simply is not the case. Only loans written at interest rates greater than the wholesale lender's par rate for that program and on that day pay YSP. Wholesale lenders routinely price and accept loans written at rates well below the par rate and pay no YSP for them. Loans written at rates below par are purchased at a discount, leading to the need for the borrower to pay "discount points". Furthermore, the YSP arises not from the difference between the present value of the interest payments but from the present value of all payments. A better technical definition would be: the difference between the present dollar value of the projected payments for a loan written at the wholesale lender's par rate for a particular transaction and the present dollar value of the projected payments based on the interest rate the broker actually obtained for the lender. In this context, "projected payments" should not be construed to be scheduled payments. Wholesale lender pricing reflects the prices offering by investors and investors model prepayment of loans according to sophisticated models and historical trends. A more practical definition is that YSP is the amount by which the price the wholesale lender pays for the borrower's note exceeds the face amount of that note (the loan amount). How can we impose regulations governing YSP if we don't understand clearly what it is – and what it is not. What YSP isn't: Ever since landmark cases like Culpepper, in which the mortgage industry was accused of taking kickbacks in the form of YSP, the mortgage industry has perpetuated the myth that YSP is a payment by wholesale lenders to mortgage brokers to compensate for certain services that the mortgage brokers provide to those lenders. This is an utterly false assertion. While RESPA permits such payments, your approach in this proposed change really captures the essence of what such payments properly would look like – you propose not to restrict lender payments to brokers if those payments are not based on interest rate. IF wholesale lenders intend to compensate brokers for any services provided to the lender, the form of that compensation would reasonably be related to the service provided, not to the interest rate on the loan delivered. In justifying current practices, brokers would have the public believe that wholesale lenders pay YSP for said services if the loan interest rate exceeds the par rate, but pay NOTHING for those same services if the loan interest rate is lower than the par rate. This kind of “compensation arrangement” simply cannot be reconciled as a payment for origination services provided. Brokers defend this claim by saying that wholesale lenders pay a higher fee for loans with higher interest rates because those loans are more valuable to the lender. If this were true, YSP would indeed sound more like a kickback or finder’s fee. But this claim is not true either. Any student of the pricing of fixed income investments should recognize that wholesale lenders are in the business of purchasing mortgage notes from borrowers and that the purchase price varies from a “discount” when the note rate is below the par rate to a “premium” when the note rate is above the par rate. This price spectrum is developed from a common assumption (or approximately common assumption) for yield on a class of notes. The wholesale lender is fundamentally indifferent as to note interest rate – the same yield is obtained regardless of the note rate. Why then should the wholesale lender offer “compensation” to the broker based in note interest rate? He wouldn’t - it’s a myth. One might hope that the financial experts of the Federal Reserve System would not buy into this myth and base regulation on it. Regarding the application of limitation of lender payments to brokers only to closed end loans: The propose change goes to lengths imposing restrictions and regulations on payments from mortgage lenders to mortgage brokers. In the summary section of the proposed change, you state that these limitations will apply only to Closed End Loans. While there may be other restrictions that provide for fairness in the HELOC market, there is a new breed of Open Ended Loan in the marketplace that is offered through mortgage brokers. An example of this is the Home Ownership Accelerator® offered by CMG Mortgage. This loan is an open ended line of credit secured by the borrower’s home, but rather than being a second mortgage, the loan is offered as the first mortgage as an alternative to the traditional closed end mortgage. The lender offers pricing on this loan that is essentially the same as that found in closed end loans. In place of a spectrum of interest rates with associated discount or premium prices, this lender price sheets show a spectrum of margin options each with an associated discount or premium price. Thus, under the proposed regulation a broker can claim YSP in originating such a loan without being regulated by this proposed change since this change applies only to Closed End Loans. Regarding the prohibition on the broker receiving excess compensation and the disclosure of YSP Your concerns that creditor payments to mortgage brokers are not transparent to consumers and are potentially unfair are well founded. Not only does the potential exist for unfair treatment, but such unfair treatment is routine. Borrowers virtually never relate the YSP to their cost for the services provided by the broker. The direction of this change seems to have the intent on rectifying this disconnect. But “more” and “better” disclosures regarding YSP and even the prohibitions proposed by this change will, unfortunately, not resolve the issue. The issue is that borrowers do not equate the total compensation that broker's receive for loan origination services as a cost that they can shop for or negotiate. And this will not change until brokers make a simple plain language dollar and cents and completely up front disclosure of the price attached to their origination services. Lawyers do it, dentists and doctors do it, and settlement agents do it. Virtually every business engaged in the provision of services to consumers can and does provide a "schedule of fees" in some form so that consumers can consider that cost in shopping for a service provider. Mortgage brokers provide loan origination services and advice that consumers need. But they seem to be unwilling to tell consumers what the will charge for those services. The existence of the supposed payment from the lender to the broker in the form of YSP only serves to complicate the consumer's ability to associate a cost to the service being provided. Your intent is appropriate – to preclude the broker from receiving more compensation for those services than agreed to. In any other service provider–consumer relationship, this is effectively monitored by the consumer himself. In other service provider relationships, the consumer knows up front what the cost will be. When the bill comes due, the consumer simply looks to see if he has been charged more than he agreed to. Because of the complication created by treating YSP as a portion of mortgage broker compensation, the consumer is virtually never in a position of "agreeing" to a set amount of broker compensation. He sees a list of fees, many of which seem confusing. He sees YSP and is told not that this is a cost he is paying but rather that it's a payment from the lender for services the broker provides to the lender. He cannot connect this into a single coherent explanation of what his is paying for origination services. Your additional disclosures are clearly intent on helping. But in the course of mortgage loan transactions, there exists such a pile of disclosures the whole point of any of them is lost – most go completely un-read. What the consumer needs is a simple and contractually clear statement from the broker – I will charge you $xxxx for the origination services I provide. To the extent that the borrower equates this declaration to a cost to be born directly by the borrower, borrowers will "feel the pain" and will shop for value, a component of which is certainly cost. To the extent that borrowers see this as a cost born solely by them, they will self enforce the agreement by paying close attention to its appearance on the settlement statement. Borrowers do watch all the third party fees closely and routinely challenge changes from the original estimate. But they seldom monitor broker compensation because they don't have their arms around its many moving parts under current practices. They don't see a connection to the complicated disclosure of those fees and the cost born by them. To the extent that this fee is made less clear by somehow blending it with payments from lenders, for example, that do not appear to the borrower to be connected to the services provided to the borrower, any such disclosure will be substantially less effective. It's time to end the myth perpetuated by mortgage brokers that YSP is compensation paid by the lender to the broker for services rendered. In the brokered transaction, the lender is, in fact, purchasing the borrower's note. The prospective purchase price varies with selected interest rate based as a result of a common (or approximately common) expected yield for a particular loan program for a particular period of time. Because the lender is purchasing the note from the borrower, every penny the purchaser pays is in fact due to the borrower. None of it represents compensation for services rendered by the broker to the lender. Thus, if a borrower chooses to originate his loan at an above par interest rate, he should expect and receive the appropriate above par price for it. The amount by which that price exceeds the purchase price is commonly called YSP and, so long as it is made fully available to the borrower, it will result in a reduction of closing costs on a dollar for dollar basis. Mortgage brokers are great at pointing out the utility of YSP in reducing closing costs, yet the only thing YSP seems to do under current practices is increase broker compensation hence closing costs. This is only possible because (a) the compensation to be paid is seldom a firmly agreed to number and (b) the borrower is largely ignorant of YSP and how to direct its use in lowering closing costs. An amazing thing happens when the broker discloses his origination fee (total compensation) up front and commits to credit 100% of YSP to the borrower at closing. With such disclosure, the borrower is for the first time (a) able to shop for originators, and (b) able to select an interest rate based on the impact it has on his closing costs. I am in favor of not only disclosing YSP but requiring every dollar of it to be credited to the borrower – it's the borrower's money. Requiring the disclosure of YSP as a means of informing the borrower about total broker compensation sounds like a good idea, but it won't really solve anything for a number of reasons: (1) The YSP will change from the date of initial disclosure to the date of lock – any early disclosure of YSP doesn't tell you anything about what it will eventually be. (2) The borrower has no clue what it is. (3) The borrower has no way to know the accuracy of the YSP disclosed – the originator is free to be creative with his disclosure of YSP in any manner that will serve his interests. (4) YSP will vary from wholesale lender to wholesale lender for the same program and will vary with time, sometimes quite dramatically. The notion that the borrower benefits from disclosure of YSP is not based on the reality of the borrower's inability to make use of that disclosure. To clarify the roll YSP plays in the transaction, the simplest rule would be a requirement that all YSP be credited to the borrower – every dollar, every brokered transaction. Under such a rule, brokers will then be free to explain to borrowers that they can choose a higher interest rate that provides additional funds (YSP) that can be used to offset closing costs, including broker origination costs. Under such a rule, borrowers will then be able to see a plain simple disclosure of what the broker's origination services are costing the borrower. For the first time, borrowers will be able to shop for origination services provider with an eye toward negotiating a fair price for those services. And for the first time, the cost of broker originations services will be set by a competitive market. This approach would not only be simple for the consumer, but would obviate any need for lenders to become enforcers as is described in the proposed change. If all YSP is credited to the borrower, it becomes just another possible source of funds to close. If the broker's fee is disclosed as a simple statement of compensation to be paid entirely by the borrower, then the borrower can (1) use that disclosed fee as a consideration in shopping for a broker, and (2) readily see on the closing settlement statement that the agreed amount alone is paid to the broker. This approach will not only clarify the costs to the borrower, simplify the regulation of brokers who might be tempted to sneak in additional charges, remove the principle source of temptation for brokers to collect more than agreed to up front, but it is also the right thing to do. Contrary to the widely held myth, wholesale lenders do not pay mortgage brokers YSP for services. Wholesale lenders simply purchase mortgage notes at a market based price. And from whom do they purchase these notes? From the owner of the note, which happens to be the borrower. The mortgage broker does not acquire ownership rights to the borrower's note during the course of loan origination. Therefore the lender is not purchasing the note from the broker but is, in fact, purchasing the note from the borrower. YSP is but a component of the price the lender pays the borrower for his note. YSP is and always has been money belonging to the borrower. Disclosing YSP as a credit to the borrower not only simplifies the whole cost disclosure mechanism, but it is consistent with the reality that YSP is borrower's money. Rather than imposing a duty of compliance on the part of lenders or any other party to make sure that the total compensation paid to the broker does not exceed that which was originally "agreed to" I ask that you simplify and clarify the pricing of origination services by requiring that YSP be credited 100% to the borrower in the brokered transaction. I urge you to take the time to revise the propose change such that all YSP is credited to the borrower in every brokered transaction. Regarding different regulations for bankers and brokers It's about time that the Fed recognized that mortgage brokers and mortgage bankers are in fundamentally different businesses. Lenders lend money, brokers provide origination services. In particular, the proposed Fed rule would require brokers, but not other mortgage originators, to disclose the specific dollar amount which the broker would earn from a transaction, including yield spread premiums. That disclosure would have to be made before the consumer paid any fee to any person, and before submitting an application. Brokers may only receive compensation disclosed in that manner. This is not only an important distinction, but one that is long overdue. The principals to the mortgage transaction are obviously the borrower and the lender. The broker has a seat at the table only by invitation of the borrower. Implicit in this relationship is the perception on the part of borrowers that brokers are acting on behalf of and in support of the borrower's interests. It is only fitting the borrower know (a) how much he will be paying for origination services, and (b) the extent to which the broker may be operating with conflicted interests. HUD already requires disclosure of yield spread premiums in both the GFE and HUD-1. However and unfortunately, borrowers are ill prepared to understand what yield spread premium is and that it is a factor over which they have control. The Fed correctly asserts that consumers believe that brokers are a "trusted advisor" who are bound to serve the best interests of the borrower. The National Association of Mortgage Brokers objects to this and to the different treatment of mortgage bankers and their originators. The NAMB seems to fail to understand the difference between the inherent interests of a product provider and a product consumer. In this context lenders equate to product providers. Their interests are at odds with those of borrowers. Brokers, who come to the table only when engaged by borrowers, necessarily represent the interests of the borrower. Since brokers and bankers represent competing interests, it is reasonable that they be addressed differently by regulations. The NAMB cites studies that demonstrate the confusion on the part of borrowers. This is all the more reason for different regulations that can serve to create a bright line distinguishing between those who serve the interests of the borrower and those who serve the interests of the lender. Clarifying these rolls will ultimately benefit consumers. This situation is analogous to situation we see in the investment industry in the differentiation between registered representatives of broker-dealers and registered investment advisors where we have a very different body of regulations governing the activities of those representing the investor's interest from those regulating the interests of the broker-dealers and investment product providers. The mortgage broker industry asks you to provide disclosure rules that create a level playing field between brokers and lenders. Given that lenders and brokers are in fundamentally different businesses, there is no reason to hold to the same set of disclosures for both forms of business. The concept of a level playing field is not applicable. A lender lends money. He make profits of either the interest paid by the borrower, or, as is often the case today, by selling the note to the secondary market at a higher price than what they paid. A broker does not lend money. A broker provides origination services which include a measure of advisory service in helping the borrower select the appropriate loan and loan terms. Brokers make their profit through fees charged for providing those origination services. The lender loans money, the broker assists the borrower in obtaining a loan. It is ridiculous for brokers to demand a level playing field between these two fundamentally different businesses. Just as we see in the securities business, there is logic in separate regulations for those who sell product and those who provide service and advice to the consumer in obtaining product. The broker ought to be seen as both an originator and an advisor working on behalf of the borrower whereas the lender is simply the lender. The informed borrower should understand that the lender's interests and the borrower's interests may not and likely will not coincide. The principle of caveat emptor applies when a borrower is working directly with a lender. The lender ought to be required to disclose relevant information that the borrower reasonably should have available in considering the loan. Brokers provide origination services and the consumer ought to provided relevant information that would help him in selecting the provider of such services, such as fees to be charged and information concerning conflicts of interest that might exist. Consumers are largely ignorant of the difference between mortgage brokers and lenders. This ignorance is at least in part due to the misleading marketing by the industry. There ought to be a bright line distinction between brokers and lenders. More specifically, there ought to be a bright line distinction between those who represent the lender and those who represent the borrower. To avoid confusion, no one should be able to represent one party for some parts of a transactions and the other for the rest. In my state brokers are permitted to operate as both a broker and a lender. This practice contributes to the confusion on the part of the borrower. And that confusion precludes the competitive market forces that would certainly benefit borrowers. An issue that unfortunately is not covered in the proposed regulation is the separation of bankers and brokers. The securities industry is wrestling with the problems that result when a registered rep is dually registered as an investment advisor. How can the consumer know which "hat" the practitioner is wearing? We have the same problem in the mortgage industry. Many brokers are also able to act as lenders. How can the consumer know which hat the loan originator is wearing? And how can you, through regulation, promote fairness to the consumer if the loan originator is permitted to wear both hats? Regarding up front disclosure of the cost of origination services I applaud your effort to force mortgage brokers to disclose up front the fees they will charge for providing origination services. Brokers contend that they cannot give a precise dollar estimate of their charges up front. This is a curious claim. It's true that if you believe that your compensation should be based on loan amount and/or interest rate then it is difficult to know what that compensation will be until those parameters are nailed down. But why should origination services be based on loan amount or interest rate? As a loan originator, I see no difference in the work I do for a borrower asking for a $1,000.000 loan and one asking for a $100,000 loan, except that I most likely will wear a tie when I am meeting with the $1,000,000 borrower. Let's face the fact that we make 5 times more money and do relatively the same amount of work if we close a $500,000 loan vs. closing a $100,000 loan (From an article by Gibran Nicholas. Gibran Nicholas is Chairman and founder of the CMPS Institute, a national mortgage originator marketing training organization.) It is true that some originations are more difficult than others – but seldom by much. The worst case might be a borrower whose qualifications are marginal for whom we might apply several times to multiple lenders before obtaining an approval. But the cost of this additional effort can be taken care of in a schedule of fees. If my doctor, my dentist, my lawyer, my financial planner, my car repairman, title and escrow companies, etc., can establish a fee schedule that can be reviewed and agreed to up front, why is this so hard for mortgage brokers? The fact is it's not hard, they just don't want to do it. One reason is the fact that as long as the borrower doesn't know how much you are making from a loan, there is no competitive pressure to provide better service at a lower fee. Another reason is the fact that, under current practices, the broker/loan originator is likely to make even more money than what is disclosed under current disclosure rules. It would be difficult to rationalize the fees charged by most brokers in today's market based on the training, experience, difficulty, or skill involved. My dentist charged me about $2,200 for two crowns this month. His fees were multifaceted and confusing, but they were fully disclosed before I agreed to his services and before we began the process. Not only is it reasonable for a dentist or a mortgage broker to be able to price his services ahead of the engagement, this example points up another absurdity in current market practices. My dentist, who completed years of study, pays significant overhead for specialized equipment, pays relatively expensive professional staff charges $2,200 to prepare and place 2 crowns. Nearly half of that fee pays for materials, including the crowns themselves. So his earnings for employing his skills are but a fraction of that total. The typical loan originator sets total broker fees at 1.5-2% of the loan amount. That means for a typical $200,000 loan, the total broker fees are likely to be in the $3-4,000 range. And for a $500,000 loan that same fee will be in the $7-10,000 range. The loan originator will typically earn 60-80% of that total. The LO typically has no paid staff, and minimal overhead. How could such a disparity exist if borrowers understood up front what HUD says they have a right to know, namely, what services are to be provided and what cost will be for those services? We need more competition. If brokers embraced their unique advantages and offered fair pricing for their services, the vast majority of borrowers would soon figure out where the best deals are to be had. In a fully, fairly, and up front disclosed origination service world, competition would establish the level of origination service pricing that is fair. This does not happen today. And with such competition, it is highly likely that brokered loans would be soon seen to beat banker loans in almost every case. Bankers would respond by trimming expenses out of their loan origination. Competition in a free market has provided more than adequate business opportunity and optimum consumer pricing for over two centuries in this country. That is true in almost every business except home mortgage origination. It's time to change that. Thank you for considering my comments on these important issues. Bradley Allen